

Quality Control Requirements for Auditors Performing Engagements under GAO and PCAOB Standards

The fall 2008 issue of **AUDIT CONDUCT NEWS** discussed quality controls over independence and ethics compliance required under [AICPA Statement on Quality Control Standards \(SQCS\) No. 7](#) (AICPA QC Statement), which went into effect on January 1, 2009. This issue highlights the quality control requirements of the Government Accountability Office (GAO) and the Public Company Accounting Oversight Board (PCAOB).

The Yellow Book—Governmental Auditing Standards

The GAO issues (Generally Accepted) *Government Auditing Standards*—or “GAGAS.” These standards are frequently referred to as “[the Yellow Book](#)” since that is the color of the book in which the standards are published. The Yellow Book provides a framework for conducting high quality audit and other attest engagements with competence, integrity, objectivity and independence. Auditors providing audit or other attest services to federally funded entities are often required by law, regulation, contract, or other agreement to perform a Yellow Book audit.

Among other things, a firm that performs audit or attestation



engagements in accordance with the Yellow Book must establish a quality control system that is designed to provide reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements. The firm must also undergo an external peer review at least once every 3 years. Firms that do not obtain peer reviews in accordance with the requirements described in [Chapter 3](#) of the Yellow Book should include a modified GAGAS compliance statement in their audit and attestation reports. However, a firm that meets these requirements by having a peer review performed is *not* required to disclose in the GAGAS compliance statement any deficiencies noted in connection with the peer review, i.e., the firm may still be able to use an unmodified compliance statement.

Firms should perform ongoing monitoring of their quality control systems by periodically assessing the work performed

on audit and attestation engagements. Monitoring procedures should help ensure that quality controls are suitably designed and operating effectively. At least annually, firms should analyze and summarize the results of these procedures; the summary should identify any systemic issues that need improvement and indicate how the firm plans to address these issues. When used alone, results of the firm’s supervisory activities *do not* constitute monitoring controls under the Yellow Book, however, the results of pre-issuance reviews may be considered as a part of the firm’s periodic reviews.

In most instances, the Yellow Book requirements are consistent with the AICPA QC Statement. For example, firms must document their quality controls and compliance with them and keep documentation long enough to enable peer reviewers and persons performing monitoring procedures to evaluate compliance with policies and procedures.

Public Company Accounting Oversight Board (PCAOB)

Shortly after its formation, the PCAOB adopted [Rule 3400T](#), *Interim Quality Control Standards*, which consist of the AICPA Auditing Standards Board's Statements on Quality Control Standards as of April 16, 2003. Firms that were members of the now-defunct SEC Practice Section (SECPS) on that date are also required to follow SECPS QC standards that were in effect at the time. These interim standards remain in effect to the extent that the PCAOB does not supersede or amend them. For example, the PCAOB has proposed a new auditing standard, *Engagement Quality Review*, which if adopted by the Board and approved by the Securities and Exchange Commission (SEC), would supersede *SECPS Requirements of Membership § 1000.08(f)*.

The following summarizes the *additional requirements* (beyond the AICPA QC Statement) pertaining to independence and ethics compliance, which are found in the SECPS QC standards:

Independence Training

The PCAOB prescribes the timing and nature of independence training. For example, under PCAOB standards, client service personnel should complete independence training near the time of initial employment and periodically thereafter. In addition, training shall address the independence rules for investments, loans, brokerage accounts, business relationships, employment relationships, nonaudit services and fee arrangements.

Restricted Entity List

Firms should maintain a database that includes all restricted entities ("Restricted Entity List") and policies should explain why, when and how SEC registrant audit clients (and their related entities) are to be placed on the list. Firms that audit more than 500 SEC registrants annually are required to have an automated system to identify investments held by partners and managers that might impair independence. Policies shall also specify that professionals, including the professional's immediate family (spouse or dependents), review the Restricted Entity List prior to (for example) obtaining a financial interest or loan in a restricted entity.

Foreign Affiliates

To help facilitate and ensure compliance with independence rules by a firm's foreign accounting firm affiliates, the firm shall provide all affiliates access to its Restricted Entity List and independence policies.

Independence Violations

A firm should require professionals to report apparent violations of its independence policies involving the professional or his/her immediate family and the corrective action(s) taken (or to be taken).

Independence Confirmations

Firms should require a professional to confirm near the time of initial employment and at least annually thereafter that he or she has read the firm's independence policies, understands them, and has been in compliance with the policies since the prior certification. Independence confirmations address

compliance of the professional and his or her immediate family.

(Note: the AICPA QC Statement does include an annual requirement to confirm independence.)

Sanctioning Policies

Firms should develop guidelines for actions to be taken against professionals for violating the firm's independence policies, e.g., sanctions that may be levied.

Monitoring Policies

Firms are required to have a monitoring system (supervised by a senior-level partner) to determine that all apparent violations are adequately addressed and documented. The monitoring system should provide reasonable assurance that firm investments (including investments held in the firm's benefit plans) comply with the independence policies and that information received from the firm's partners and managers is complete and accurate.

Inspection Procedures

The monitoring system will generally include auditing, on a sample basis, selected information such as income tax returns, bank or brokerage statements, or alternative procedures that accomplish the same objective. These policies and procedures apply not only to engagements performed by the firm but also to engagements performed for SEC registrant clients by the firm's foreign affiliates.

If you are interested in enhancing your firm's quality controls, contact Cathy Allen at callen@auditconduct.com or (631) 737-0365, or visit www.auditconduct.com/clients.php for a description of services offered.